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Service Offshoring

Is Europe Different?

The discussion on the international relocation of jobs in the services sector is not as advanced in Europe as in the USA, where a broad consensus has emerged in recent years that offshoring has very modest effects on the US labour market. One of the key challenges in the European discussion remains the determination of the magnitude and the patterns of offshoring, as the necessary data are often unavailable at the European level. The following article offers a tentative comparison of the effects of offshoring in Europe with those in the USA.

The relocation of jobs from one country to another, frequently referred to as offshoring, is not a new phenomenon. The international movement of manufacturing jobs has had a strong influence on the labour markets of OECD countries for many decades. Today there is growing concern that service sector jobs might follow suit: popular examples are the relocation of call centres and computer programming to India. Public controversies have been especially strong in the USA, where they became one of the focal points of the presidential election in 2004. Concerns about whether the country was facing another daunting labour market challenge besides the familiar deindustrialisation process were not only fuelled by media reports on individual cases of job loss but also by the "jobless recovery", a sluggish labour market recovery following the economic slowdown of 2001.

The controversies were ignited by the release of the Economic Report of the President in February 2004.[1] A chapter on international trade in the report and statements made by the Bush administration at the time of its release indicated that the government was treating service offshoring as business as usual. The US administration claimed that the essential economics behind international trade in services are the same as those behind trade in goods and that it does not matter whether imports come on ships or, as many services do, via cable. According to the administration, international trade in services is a win-win situation in which both trading partners gain. Consequently it announced that it would continue to negotiate free trade agreements. And indeed the USA not only pushed for the liberalisation of services trade in the Uruguay Round negotiations at the WTO but also in the many bilateral agreements which it has ratified in recent years.[2]

The policy stance of the Bush administration was seen by many as neglect of the interests of American workers. It was the lack of any indication of concern over the consequences of offshoring for American service employees which gave the Democratic presidential candidate John Kerry an opportunity to distinguish himself. In his recommendations on how to cope with this new trend in international economics, Kerry focused among other things on the tax code, which according to his view included provisions that unjustifiably furthered offshoring. He also asked for an extension of existing support programmes for American workers. Trade Adjustment Assistance (TAA), a federal programme which has financed education and unemployment benefits for workers in manufacturing, who have been losing their jobs due to import competition for many decades, was to be expanded to the service sector.

Although pointing in opposite directions, the arguments made in early 2004 by the Bush and Kerry camps both have merits. Together they indeed carve out territories for discussions in the years to come, not only in the USA but also in Europe, to where the controversy on offshoring eventually spread. With its comments the Bush administration made the valid point that structural change – whether it is caused by international trade, including trade in services, or

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[1] Cf. N. G. Mankiw, P. Swagel: The Politics and Economics of Offshore Outsourcing, NBER Working Paper, No. 12398, 2006; Economic Report of the President, Washington DC 2004, available at: http://www.gpoaccess.gov/usbudget/fy05/pdf/2004_erp.pdf.

[2] Cf. J. Sindt: Competitive Liberalization, MA Thesis in International Relations, Jacobs University, Bremen 2008; J. Whalley: Recent Regional Agreements: Why so many, why so much variance in form, why coming so fast, and where are they headed? CESifo Working Paper, No. 1790, 2006.

by technological progress at home – is the principal source of rising living standards.

At the same time it is indisputable that, as John Kerry pointed out, not all citizens gain from international trade equally and that trade produces not only winners but also losers. In trade theory, the distribution effects of trade are as clearly formulated (in the Stolper-Samuelson theorem) as the overall welfare gains (in the underlying Heckscher-Ohlin theorem). Moreover, experience with the globalisation process over the last decades confirms these insights.[3] In the USA, increasing trade in manufactures with developing countries like China contributed to rising income inequality. In Europe, where downward adjustment of wages is more limited, international trade worsened unemployment among blue-collar workers. Making attempts at helping those who lose their jobs due to import competition through government programmes such as TAA makes sense not only for trade in goods but also for trade in services.[4]

Although the 2004 public controversies helped to define the discussion on service offshoring for many years to come, they left many key questions unanswered, for example that on the scale of this new phenomenon: are the USA and other OECD countries losing a few jobs here and there due to offshoring or are they already in the grip of a mass movement as the occurrence of the "jobless recovery" in the USA might suggest? Whatever the magnitude of offshoring at present, how will this new phenomenon develop in the future? How many and what kind of jobs will be affected in the years to come?

Closely related to questions of magnitude, current and future, is that of incentives and disincentives of the offshoring process. With the "tradability revolution", the 2004 debate had already pointed out one of the main determinants of international services trade. The fact that a growing number of services can be stored electronically and delivered via cable over long distances at low cost is one of the strongest driving forces behind the transformation of world service markets at the beginning of the 21st century. But are there other factors that determine the magnitude of service offshoring besides technical feasibility? And how important are the positive effects of offshoring such as cost reductions and increased productivity for the offshoring economies? Because these questions have been discussed in a large number of studies with a focus on the US economy, the American experience remains an important point of reference for other countries, including the member countries of the European Union.

Inadequate Statistics

Almost any discussion on service offshoring has to first attempt to answer a seemingly simple question: What jobs are currently being lost? Academic discussion has found it difficult to answer this question adequately and it is the lack of any reliable data on offshoring-related job loss in both the USA and Europe which characterises discussions on this topic until today.[5]

As some services are traded internationally and others are not, not only trade belongs to the larger picture of global service markets, but also capital flows, especially in the form of foreign direct investment (FDI), and trans-border movement of service personnel. Offshoring, as discussed in recent years, focuses on a very specific aspect of this many-facetted division of labour. In leading American studies, service offshoring is defined as workforce reductions due to closure or downsizing of a firm in the home country and workforce expansion in a foreign country for the provision of the same services. Most definitions focus on the displacement of domestic service employees and imply an increase in service imports.[6]

From the perspective of the firm there are two possibilities for such relocation: captive offshoring, in which affiliates of a domestic firm are opened or expanded abroad, and offshore outsourcing, in which service purchases are shifted from a domestic source to non-affiliated foreign firms. All these activities are in principle subject to official statistics. Job losses in the domestic economy are accounted for in official labour market statistics. The service imports that accompany the international relocation of a job are reflected in balance of payments statistics. If a domestic firm opens or expands a foreign affiliate instead of entering into a

[3] For an overview of the discussion on the effects of international trade on income distribution in the USA see W. R. Cline: Trade and Income Distribution: The Debate and New Evidence, Petersen Institute for International Economics, Policy Brief 99-7, 1999. For evidence on the income distribution effects of international trade in the last globalisation period see K. H. O'Rourke, J. G. Williamson (eds.): Globalization and History: The Evolution of a Nineteenth-Century Atlantic Economy, Boston 2000, MIT Press.

[4] H. F. Rosen: Reforming Unemployment Insurance for the 21st Century Workforce, Petersen Institute for International Economics, 2007; R. Rubin: Challenges for the US and Germany in Today's Global Economy, Speech, Social Democratic Party Forum, Berlin, Germany, unpublished manuscript, 16 June 2006.

[5] For an analysis of available data on service offshoring see J. F. Kirkegaard: Offshoring, Outsourcing, and Production Relocation – Labor-Market Effects in the OECD Countries and Developing Asia, Peterson Institute for International Economics Working Paper No. 07-2, 2007, pp. 5-14.

[6] National Academy of Public Administration: Off-Shoring: An Elusive Phenomenon, 2006, p. 38, available at: www.bea.gov/papers/pdf/NAPAOff-ShoringJan06.pdf; United States Government Accountability Office: Offshoring of Services: An Overview of the Issues. Report to Congressional Committees, 2005, p. 5, available at: http://www.gao.gov/new.items/d065.pdf.

contract with an unaffiliated foreign service supplier, offshoring will furthermore be accompanied by outward FDI, which is again part of balance of payments statistics.

While there are quite a few starting-points to determine the magnitude of offshoring, none of the abovementioned statistics make the connection between job loss in the domestic economy and service imports which is at the heart of the current offshoring debate. Labour market statistics have traditionally paid no attention to trans-border economic activities such as service imports or outward FDI and only as recently as 2004 did the US Bureau of Labor Statistics (BLS) include offshoring as a possible cause of job loss in its statistics.[7] Balance of payments statistics on the other hand have no formal link to job losses and job gains in the national economy although they are very often used to estimate the effects that international trade has on the labour market.

Besides official statistics, another group of sources has played an important role in the offshoring debate. First insights into this phenomenon came from business consultants. Because international corporate restructuring belongs to the core activities of these firms, they have considerable knowledge in the field. But the studies undertaken by them have to be taken with a grain of salt. Although the firm level data presented in many of these studies are in principle the best source for examining the connection between job loss and service imports, many of the surveys are taken from small populations and their methodologies are not transparent. Quite often these studies are not even publicly available. Because business consultants are in close contact primarily with firms that have already offshored or are likely to engage in such activity, many of these studies may very well overestimate the magnitude of this process.

A third source of data on offshoring is the systematic analysis of press reports. While this approach depends on the extent to which offshoring activities are covered in the press, it has the advantage that it relies on verifiable public sources. For Europe, where there are no official labour market statistics on offshoring on an EU-wide basis, such data are available from the European Restructuring Monitor (ERM).[8]

Modest Effects

Although the data on offshoring are far from satisfactory, a broad consensus on some of the key questions of this phenomenon has emerged in recent years with respect to the US economy. On the question of the current magnitude of job loss the results of quite a few different studies lead to the conclusion that offshoring has very modest effects on the US labour market compared to other determinants of job loss and job gain.[9] Even authors who emphasise that service offshoring is a serious threat to American workers admit that the amount of offshoring is too little to have made a considerable contribution to the staggering job loss in the early 2000s.[10]

The best statistics to determine the extent of job loss are the Mass Layoff Statistics (MLS) of the US Bureau of Labor Statistics (BLS). Since January 2004 they include a category for "movement of work", which has become the basic vehicle for measuring offshoring in official statistics in the USA.[11] The questions that were added to the MLS employer interview concern all four different categories of domestic and overseas production relocation: domestic in-house relocation, domestic outsourcing, captive offshoring and offshore outsourcing.

The results of this survey for the first four years show that the total number of job losses associated with movement of work domestically and internationally is over 50 000 per year, or 9.8% of all permanent mass layoffs. This figure is considerably smaller than for example the figures for mass layoffs due to downsizing or contract completion. More importantly, mass layoffs associated with the movement of work for which employers were able to provide more specific information indicate that only 3.4% of all mass layoffs can be attributed to offshoring (including captive offshoring and offshore outsourcing) while 6.2% are due to domestic relocation (including domestic in-house relocation and domestic outsourcing). The preferred route for offshoring is captive offshoring which accounted for 2.8% of all mass movements. Offshore outsourcing amounted only to 0.6%. Year-to-year fluctuations of these job losses are relatively small. They do not show a clear trend (Table 1).

While giving the broadest and most reliable empirical evidence on offshoring in the USA, MLS also has some serious problems.[12] The main issue is that it focuses on mass layoffs, leaving out smaller separations. MLS records only about 10% of the total number of all

[7] S. P. Brown, L. B. Siegel: Mass layoff data indicate outsourcing and offshoring work, in: Monthly Labour Review Online, Vol. 128, No. 8, 2005.

[8] Cf. European Monitoring Centre on Change (EMCC), available at http://www.eurofound.europa.eu/emcc/erm/index.htm.

[9] National Academy of Public Administration, op. cit., p. 57.

[10] J. Bivens: EPI Issue Guide: Offshoring, Economic Policy Institute, 2006, available at: www.epi.org/content.cfm/issueguide_offshoring.

[11] S. P. Brown, L. B. Siegel, op. cit.

[12] U. Demiroglu: Offshoring of Service Jobs, Munich Personal RePEc Archive Paper 6438, 2007, pp. 13, 32, available at: http://mpra.ub.uni-muenchen.de/6438/3/MPRA_paper_6438.pdf.

Table 1
US Job Losses from Production Relocation, 2004-2007

	2004-2007		2004	2005	2006	2007
	Absolute value		Percentage share			
Total number of mass layoffs, excluding seasonal and vacation related	2338120	100.00	100.00	100.00	100.00	100.00
Total number of mass layoffs associated with movement of work	229076	9.80	11.41	10.44	9.60	7.72
Total number of mass layoffs associated with movement of work for which employers were able to provide specific information regarding the movement of work components	153531	6.57	8.59	6.66	5.86	5.02
Domestic relocation	96458	6.16	7.50	6.56	5.83	4.62
- domestic in-house relocation	81960	5.23	6.37	5.23	5.14	4.05
- domestic outsourcing	14498	0.93	1.13	1.32	0.69	0.57
Out-of-country relocation	53450	3.41	3.35	3.67	3.77	3.03
- captive offshoring	44006	2.81	2.67	2.88	3.32	2.53
- offshore outsourcing	9444	0.60	0.68	0.79	0.45	0.50

Data source: US Department of Labor. Mass Layoff Statistics, available at: http://www.bls.gov/mls/#tables
Note: The original terminology employed by the US Department of Labor was altered in Table 1. "Domestic relocation: Within company" became "Domestic in-house relocation" and "Domestic relocation: Different company" became 'Domestic outsourcing". The "Out-of-country relocation" components were changed to "Captive offshoring" (instead of "Within company") and "Offshore outsourcing" (instead of "Different company").

layoffs as recorded by the Job Openings and Labor Turnover survey of the BLS.[13] It is restricted to layoffs of more than 50 employees. Furthermore, MLS only gives information on the sectoral distribution of layoffs. It does not indicate whether separations involve service jobs or production jobs. While manufacturing industries account for about two thirds of offshore-related layoffs, quite a few of them will concern service occupations.[14] This number implies that even the figure of 3.4% has to be considered an upper limit for job losses due to service offshoring. Moreover, it shows that US service firms are not yet very active in the offshoring process compared to manufacturing firms.

The fact that there is only a very modest amount of offshoring-related job loss on the other hand does not mean that the global relocation of service jobs might not already have a strong influence on specific industries and occupations – or that it may not turn out to be a very dynamic process in the near future. Service offshoring is especially widespread in IT services and in IT-enabled services. Studies of consultants have shown that IT services, more so than IT-enabled services, are at the forefront of the offshoring movement.[15] But even here, pinpointing the effects of offshoring on domestic jobs is not an easy task.

As a group, IT-service employees have recently not been in a worse, but in a better, position than employees in other industries regarding employment opportunities and earnings, despite the burst of the dotcom bubble in the late 1990s. Indeed, only few IT occupations seem to have felt the pinch from offshoring, most notably computer programmers. While the IT industry had employment growth of 4.3% in the period 1999 through 2004, the number of IT programmers decreased by 22%. Still, even this group experienced positive wage growth, possibly due to compositional change within the IT industry.[16]

Prognosis

For the question of how many and what kind of jobs will be lost in the future, estimates are naturally further apart. Figures for jobs at risk of being offshored are between 10 and 20% of all service sector jobs over different time periods.[17] As this number is roughly equivalent to the total number of jobs in manufacturing, the USA might very well stand at the beginning of another "industrial revolution", or, in other words, a restructuring process with far-reaching consequences for the whole economy.[18] But how do studies arrive at such estimates? Although methods differ significantly, most of the studies focus on the tradability of services, assuming that all tradable services are at risk of being offshored over the long run. Criteria used to identify such services include, among others, intensive use of

[13] For more information on the Job Openings and Labor Turnover survey, see http://www.bls.gov/jlt/.

[14] US Bureau of Labor Statistics: Extended Mass Layoffs, various quarterly and yearly reports, available at: http://www.bls.gov/.

[15] Cf. for example D. Farrell et al.: The Emerging Global Labour Market, McKinsey Global Institute, 2005, available at: http://www.mckinsey.com/mgi/publications/emerginggloballabourmarket/index.asp.

[16] U. Demiroglu, op. cit., p. 39; Global Insight: The Comprehensive Impact of Offshore IT Software and Services Outsourcing on the U.S. Economy and the IT Industry. 2004, available at: http://www.itaa.org/itserv/docs/execsumm.pdf.

[17] United States Government Accountability Office: International Trade: Current Government Data Provide Limited Insight Into Offshoring of Services, 2004, available at: http://www.gao.gov/new.items/d04932.pdf.

[18] A. S. Blinder: Offshoring: The Next Industrial Revolution?, in: Foreign Affairs, Vol. 85, No. 2, 2006, pp. 113-128.

codified knowledge, a limited need for face-to-face contact and intensive use of information and computer technology (ICT). Other determinants of future job loss receive considerably less attention, as for example the fact that ICT will be used increasingly throughout all service industries in the future and that quite a few services that are currently not tradable can be split up by firms into tradable and non-tradable components and thus become partially tradable. There are already quite a few examples for such disassembling of service activities. While for example radiology services – like many other medical services – require face-to-face contact, a specific component of these services, radiology reading, can be codified, standardised, digitised and consequently traded. Radiology reading is indeed one of the examples of a service that has already been offshored to a large degree.[19]

A quite elegant method that encompasses the cumbersome and not very transparent process of evaluating the tradability of services individually is that by Jensen and Kletzer.[20] Based on a model of economic geography by Paul Krugman, the authors focus on the regional patterns of the activities of service industries and occupations in the US economy to determine whether or not a specific service is vulnerable to international sourcing. They assume that service activities that can be traded tend to be geographically concentrated in order to take advantage of increasing returns to scale, access to resources, etc. Services that are not tradable, on the other hand, tend to be more evenly distributed throughout the country. The study concludes that 13.7% of jobs in professional services are tradable, a larger share than in manufacturing industries (12.4%). Turning to occupations, the study finds especially large shares of tradable jobs in computer and mathematical occupations (100%), in legal occupations (96%) and in business and financial operations (68%). Industries with large shares of non-tradable jobs include education and library (99%), healthcare support (97%) and food preparation (96%).

Although the study by Jensen and Kletzer stands out as an elegant approach to the question of jobs at risk of being offshored, it suffers from the same systemic weaknesses as other studies that look into the future of this new trend. Technical tradability, the main focus of these studies, is only a necessary but not a sufficient condition for service offshoring. Firms will consider offshoring only if the wage differential between the home country and the country of destination is large enough to make up for the many disadvantages that the production of a service in a remote location under uncertain economic conditions brings about. These disadvantages include macroeconomic instability, a lack of good governance including weaknesses in the legal framework and especially in property rights and privacy rules, insufficient physical and digital infrastructures and, for many front office services, a lack of adequate foreign language skills. Nevertheless quite a few authors conclude that technical tradability will eventually translate to a large extent into actual offshoring. A study by the UNCTAD for example argues that global restructuring in services will be much faster than in manufacturing due to lower capital requirements and sunk costs in most service industries, weaker links to local suppliers, the fast dissemination of ICT and the fact that not only the service sector but also the manufacturing sector is affected by service offshoring.[21]

There is a broad consensus in US studies that the single most important reason for service offshoring is cost savings due to labour cost differentials. Depending on the market structure of the industries involved, such savings can lead to lower prices, higher profits, better quality of services, investments into new service activities and higher productivity. Offshoring thus offers a variety of attractive opportunities for consumers, service providers and companies that use services as intermediate inputs for their production.

For workers who lose their jobs due to service offshoring, the many positive effects of this trend on the domestic economy are of course less important. For such individuals as for the economy as a whole, one of the key questions about the effects of offshoring is whether and how fast a switch to new service activities can be made within offshoring firms or elsewhere in the economy. Estimates of the economic benefits to the offshoring country rest crucially on assumptions on rates of redeployment and refurnishment, that is, how much newly created jobs pay. An example of an overly optimistic assumption for the USA can be found in a study by McKinsey. This study takes the time period 1979 through 1999 as reference to estimate redeployment and refurnishment rates – a period of exceptionally high growth rates and, more importantly, the development of the dotcom bubble. The resulting assumptions that 69% of displaced service workers will find new jobs within one year and that these workers will earn 96% of their former wages are very likely to

[19] F. Levy, A. Goelman: Offshoring and Radiology, Massachusetts Institute of Technology, IPC Working Paper, No. 05-007, 2005.

[20] J. B. Jensen, L. G. Kletzer: Tradable Services: Understanding the Scope and Impact of Services Outsourcing, Institute for International Economics Working Paper Series, Vol. 5, No. 9, 2005.

[21] United Nations Conference on Trade and Development: World Investment Report 2004: The Shift Towards Services, p. 153, available at: www.unctad.org/en/docs/wir2004_en.pdf.

be too optimistic for the early 21st century.[22] Likewise, McKinsey's estimates for Germany of a redeployment rate of only 40%, based on a time period before substantial labour market reforms were enacted, is likely to be too pessimistic. Whatever the flaws of these specific estimates, differing rates of redeployment and refurnishment point to the fact that effects of offshoring will by no means be the same for all OECD countries. As in the deindustrialisation process, the flexibility of labour markets will make an important difference in service offshoring as well.

Europe's Intricacy

For Europe, the discussion on job relocation in the service sector is by far not as advanced as for the USA, not least of all because there is no common experience with this phenomenon. Significant wage differentials place old and new EU member countries in quite different positions concerning the offshoring process. An important topic for the offshoring debate in Europe is "near-shoring", that is, offshoring of service jobs from the EU15 to countries which joined the EU in 2004 and 2007 and to eastern Europe. There are, however, also significant differences in the offshoring activities of EU15 member countries.

Ireland for example is well-known as a target for FDI from North America and other EU member countries such as Germany and the UK. These capital flows have contributed significantly to job creation in the Irish economy in the last years and decades. Ireland is, in other words, an example of a country with a remarkably high level of inshoring. At the same time, various indicators show that the Celtic Tiger also has one of the highest rates of offshoring among EU member countries. The UK and some Scandinavian countries also seem to be more active in service offshoring than other EU member countries and again studies show that international sourcing leads not only to job loss but also to significant job gain due to inshoring.

Given the complex structure of service activities in Europe and the fact that there are no official mass layoff statistics for the entire EU comparable to those compiled by the US Bureau of Labour Statistics, one of the key challenges for the European discussion remains the determination of the magnitude and the patterns of offshoring. As long as there are no satisfactory answers to these basic questions, more far-reaching issues such as the future development of offshoring in Europe and economic effects beyond job loss and job gain cannot be properly explored.

The best available data on offshoring in the EU is based on press monitoring. Financed by the European Commission, the European Restructuring Monitor traces job losses due to restructuring since 2002.[23] Restructuring cases are recorded in a standardised fact sheet through a review of the business press in the 27 member countries and Norway. As with the MLS data of the US Bureau of Labor Statistics, the ERM data suffer from omission. Job losses are only considered if they involve an announced or actual reduction of at least 100 jobs, or a reduction of at least 10% of the workforce of firms employing more than 250 people. Again information is given on a sectoral basis and service firms initiate only about a third of all separations connected to offshoring.[24]

A direct comparison of ERM data with MLS data shows a significantly higher level of offshoring activity for Europe (Table 2). For the time period 2004 through 2007, mass layoffs due to trans-border movement of work amount to 7.8% in the EU15 compared to 3.4% in the USA. As for the USA, year-to-year fluctuations of job losses related to offshoring are relatively low (with the exception of 2005).

But there are significant methodological problems with comparing offshoring in Europe and the USA on the basis of ERM and MLS data. These are (a) that ERM does not indicate offshoring out of the entire EU but only out of individual member countries and (b) that small countries have higher natural levels of cross-border activities (and lower levels of within-country activities) than large countries.[25] If anything, these pitfalls indicate that offshoring is more modest in the EU15 than ERM data indicate. The fact that ERM provides information only on offshoring out of individual countries of the EU, that is, on within-EU offshoring and out-of-EU offshoring combined, means that the amount of job loss due to out-of-EU offshoring will be significantly smaller than 7.8%. If for example within-EU offshoring accounts for 50% of all offshoring, only 3.9% of all mass layoffs in EU15 member countries are due to out-of-EU offshoring. The fact that small countries have a higher natural rate of trans-border activities on the other hand means that EU member countries should be expected to have higher levels of international movement of work and lower levels of domestic movement of work than the USA. For domestic movement of work, ERM data indeed show a much lower level of activity: an average of

[22] Cf. L. A. Tyson: Offshoring: The Pros And Cons For Europe, Business Week, 6 December 2004.

[23] For more details see European Monitoring Centre on Change, op. cit.

[24] European Restructuring Monitor Statistics, original database provided by the EMCC, own calculations.

[25] On the trans-border activities of small countries see P. R. Krugman, M. Obstfeld: International Economics: Theory and Policy, Boston 2009, Addison Wesley, pp. 10-17.

Table 2
EU15 Job Losses from Production Relocation, 2004-2007

	2004-2007		2004	2005	2006	2007
	Absolute values	Percentage share				
Total number of mass layoffs, excluding seasonal and vacation related	1547369	100.0	100.0	100.0	100.0	100.0
Total number of mass layoffs associated with movement of work	161489	10.4	9.8	7.7	12.8	12.8
Domestic relocation	40684	2.6	1.6	2.0	3.1	4.6
- domestic in-house relocation	28994	1.9	0.9	1.6	2.5	2.7
- domestic outsourcing	11690	0.8	0.7	0.3	0.6	1.9
Out-of-country relocation[1]	120805	7.8	8.3	5.8	9.7	8.2

[1] Individual data on "Captive offshoring" and "Offshore outsourcing" were not available.

Data source: European Monitoring Center of Change: European Restructuring Monitor Statistics, Original database provided by the EMCC: Announcement Dates
Note: For easier comparison with Table 1 the terms from ERM were slightly changed. The terms used in the original ERM statistics are "Relocation" (for "Domestic in-house relocation"), "Outsourcing" (for "Domestic outsourcing"), and "Offshoring-delocalisation" (for "Out-of-country relocation").

2.6% for individual EU member countries versus 6.2% for the USA (Tables 1 and 2).[26]

While the amount of offshoring activities in western European countries is most probably not higher than in the USA despite their smaller size, ERM data show that there are remarkable differences in the level of individual member countries. Compared to its total private labour force, Ireland has more than four times the average amount of offshoring of the EU15. Clearly above average are also the UK, Finland, Denmark and the small countries Luxembourg and Belgium (Table 3). These results show some similarities with results from studies by consultants, which put special emphasis on the importance of Ireland and the UK as European countries with high levels of offshoring activities. Forrester claims that more than 70% of all offshoring expenses originate in the UK and Ireland.[27] A study co-authored by Roland Berger and UNCTAD estimates that the UK alone accounts for more than 60% of all offshoring activities in Europe.[28]

Table 3
Intensity of Out-of-country Relocation

	2004-2007
EU15	100
Austria	67
Belgium	184
Denmark	252
Finland	286
France	99
Germany	64
Greece	0
Ireland	406
Italy	27
Luxembourg	423
Netherlands	66
Portugal	160
Spain	22
Sweden	129
United Kingdom	206

Data sources: European Monitoring Center of Change: European Restructuring Monitor Statistics, original database provided by the EMCC; Eurostat: European Labor Force Survey, available from: http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,45323734&_dad=portal&_schema=PORTAL&screen=welcomeref&open=/data/popul/labour&language=en&product=EU_DB_MAIN_TREE&root=EU_DB_MAIN_TREE&scrollto=127>.

Note: Out-of-country relocation/total private employment (Index: EU15 = 100).

What are the reasons for the significant differences in the offshoring activities of individual member countries? Although there is no exact information on Finland, its high level of activity might be due to its close economic and cultural ties to a single country, neighboring Estonia, which has a well-educated labour force and a significantly lower wage level.[29]

A closer look at Ireland shows that its strength as a European manufacturing platform is accompanied by a similar strength in services. While Ireland's official labour market statistics do not identify the labour market effects of offshoring, most telling about these effects are statistics on FDI. Apart from Luxembourg, Ireland is by far the most FDI-intensive economy in the EU. Foreign-owned companies account for almost 50% of employment in manufacturing compared to 23% in EU15 member countries. But Ireland also has the highest share of services-sector employment in

[26] Another methodological problem with comparing offshoring in Europe and the USA on the basis of ERM and MLS data is that ERM data do not provide coherent information on "layoff timeline" and "layoff start". All numbers presented in this paper are based on "announcement date", that is, the date when the restructuring was announced for the first time in the press.

[27] Cited in T. Meyer: Offshoring an Neuen Ufern: Nearshoring nach Mittel- und Osteuropa, Deutsche Bank Research, Economics 58, 2006, p. 12, available at: http://www.dbresearch.de/PROD/DBR_INTERNET_DE-PROD/PROD0000000000200245.pdf.

[28] UNCTAD: Service Offshoring Takes Off in Europe, Press Release, UNCTAD/PRESS/PR/2004/01314/06/04, 2004. Available at http://www.unctad.org/Templates/Webflyer.asp?docID=4865&intItemID=2527&lang=1.

[29] J. F. Kirkegaard, op. cit., p. 10.

foreign-owned firms. In 2002 its share of 22% compares with 10% for the EU15 and 16% for Hungary, Poland and the Czech Republic.[30]

Ireland's most successful manufacturing industries are computer hardware, pharmaceuticals and medical and precision instrument engineering. Leading service sector industries are computer software, financial services and other business services. Among the drivers of Ireland's success are an English-speaking environment, the EU accession in 1973, the quality of the telecommunications infrastructure and a low corporate tax rate. Various policy initiatives to attract foreign capital are coordinated by the country's Industrial Development Agency (IDA).[31]

As for Ireland, the English language makes the UK a natural destination for international sourcing activities in Europe. The UK has had a strong services sector for a long time, but this strength has been coupled with a relative weakness in manufacturing.[32] Besides analysis-intensive and creative industries, the UK's most remarkable strong point is the financial services sector. And although London has had the status of an international financial centre for quite a while, the current offshoring discussion has not given much attention to this crucial aspect of international sourcing activities in Europe. Known as the Eurodollar Market, London started to take over numerous activities from the USA in the late 1950s and eventually also from other European countries. In the 1970s, rising oil prices and the need for international petro-dollar-recycling attracted customers from other parts of the world to the city. Although wholesale banking and investment banking are not very labour-intensive compared to other service sector activities, the pure magnitude of international financial business transacted in the UK has had a significant positive effect on its economy.

Scandinavia offers more insights into international service activities. A study on Denmark shows that for a labour market that is significantly more flexible than that of other EU member countries, the net employment effects of international service sourcing are positive. In the IT and manufacturing sectors, offshoring of predominantly low-skilled jobs is more than offset by inshoring of higher-skilled jobs.[33] A study on Sweden finds that service offshoring is on the rise, but that the growth of service inshoring is even stronger. The shift from domestic to foreign suppliers is predominantly a shift to other high-income countries. Not surprisingly, these activities do not have significant effects on the composition of labour demand. The slight negative effect they have on workers with low levels of education is largely due to offshoring to central and eastern Europe.[34]

Although this short review of European countries with high levels of offshoring activities is far from conclusive, insights on the EU15 contrast with the main conclusions from the US discussion with its narrow focus on job losses. Quite a few European countries with high rates of offshoring also have high rates of inshoring. Also, European countries do not conform to the US view of international sourcing activities as a one-way street for other reasons. Ireland and the UK have in common that massive capital inflows from the USA and other European countries do not lead to significant service exports to the countries of origin of these capital flows but to other EU member countries. Investments into these two countries are to a large degree market seeking, not efficiency seeking. But also offshoring in Sweden and Denmark is predominantly a north-north phenomenon, related to a general tendency towards production fragmentation and differentiation, rather than to cost savings in labour intensive activities.

Similar insights can be gained from balance of payments statistics. Although these statistics have quite a few flaws and do not provide a direct link to job losses and gains related to offshoring, they offer a glance at the larger (and possibly more relevant) picture of comparative advantage in international service markets. These statistics indicate that international service trade is predominantly trade between industrialised countries, not only for the EU15, but also for the USA.[35]

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[30] F. Barry: FDI and Irish Economic Development over Four Stages of European Integration, 2006, p. 1, available at http://www.iadb.org/intal/aplicaciones/uploads/ponencias/foro_bid-cepii_2006_01_barry.pdf.

[31] F. Barry, D. van Welsum: Services FDI and Offshoring into Ireland, paper prepared for the OECD Directorate for Science, Technology and Industry Panel Session on Offshoring, 2005, available at http://www.oecd.org/dataoecd/14/0/35032060.pdf.

[32] J. Woudhuysen: The globalisation of UK manufacturing and services, 2004–24: toward the Agile Economy, UK Trade and Investment Services Working Paper 05-07-2004, 2004.

[33] P. D. Jensen, J. F. Kirkegaard, N. S. Laugesen: Offshoring in Europe - Evidence of a Two-Way Street from Denmark, Institute for International Economics Working Paper Series, Vol. 6, No. 3, 2006.

[34] K. Ekholm, K. Hakkala: The Effect of Offshoring on Labour Demand: Evidence from Sweden, Research Institute of Industrial Economics Working Paper Series, No. 654, 2005.

[35] Balance of payments statistics on international trade in services have been used in quite a few analyses of service offshoring. See for example: OECD: Information Technology Outlook 2006: Highlights, available at: www.oecd.org/dataoecd/27/59/37487604.pdf; OECD: Offshoring and Employment: Trends and Impacts. 2007, available at: www.oecd.org/document/22/0,3343,fr_2649_34557_38743126_1_1_1_1,00.html; United Nations Conference on Trade and Development, op. cit.; World Trade Organization: World Trade Report 2005: Exploring the links between trade, standards and the WTO. 2005, pp. 265-294, available at: http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report05_e.pdf.

Transactions in the two categories of services trade most relevant to service offshoring – business services and computer and information services – show that OECD countries dominate not only the demand side of global service markets but also the supply side. OECD countries accounted for 83% of all exports in a group of 30 leading exporters in 2004. Among the top 10 exporters only two, China and Hong Kong, do not belong to the OECD. The largest exporters worldwide are the USA, the United Kingdom, Germany, the Netherlands and Ireland. Together these five countries represent 43% of all exports. Many of the largest exporters are also the largest importers. Countries which together represent more than 40% of service imports are Germany, the USA, the United Kingdom, the Netherlands, Italy, and France.[36] Remarkably, the USA, which has quite a dramatic deficit in its merchandise trade, has a significant surplus in its services trade resulting in a positive net effect on employment.

Admittedly, data on FDI, which might be used as an indicator for upcoming change in the international division of labour, show a different picture, with a much stronger focus on activities outside the OECD. But even offshoring of jobs in call centres, the most prominent example of an efficiency-seeking activity mainly driven by labour cost savings, was still to a large degree an intra-OECD phenomenon in the early 2000s. Out of 500 new FDI projects in 2002-2003, more than 50% were initiated in OECD countries and again Ireland and the UK played a major role as target countries.[37]

Nearshoring

Quite significant wage differentials between the EU15 and new member countries from central Europe may suggest that offshoring activities between these two country groups are more consistent with the perceptions of such activities as efficiency seeking. Old EU member countries may offshore labour-intensive services to a large degree to new member countries because of the wage cost differential. And indeed offshoring has reached a remarkably high level by international standards in the manufacturing sector, at least from the perspective of the rather small central European economies.[38]

But what about service offshoring? A study by Deutsche Bank Research draws an ambivalent picture of such activities in central and eastern Europe.[39] While the study points out that labour costs in the new EU member countries are only one fifth of those in Germany, it also notes that these costs are rising rapidly – at an average rate of 8% per annum from 1996 to 2004. Other prerequisites for the offshoring of service activities from old to new member states are not met, especially in one of the most crucial areas, IT services. New EU member countries have a remarkably low level of IT graduates and of IT service exports. Only 2% of university graduates have IT degrees compared to 4% in the old member countries. On the other hand the new members have a competitive advantage in complex back office activities such as accounting and personnel. Compared to low wage countries in other regions of the world, these countries furthermore enjoy the advantages of stronger cultural ties, better language skills and of geographical proximity.

While the study by Deutsche Bank Research provides little information on the magnitude of offshoring to central and eastern European countries, balance of payments statistics indicate that the net effects of service trade on jobs was positive only in a few of these countries in recent years. Because of the small size of their economies, the new member countries fail to appear in rankings of the world's leading importers and exporters of business services and computer and information services. Significant activities in international service markets of these countries turn up instead in the growth rates of their international trade.[40] The Baltic States are among the new member countries with the highest annual growth rates in service exports. Between 1995 and 2004 Latvia reached a staggering 57%. Growth rates were also very high in Estonia (35%) and Lithuania (30%). Other new member countries with high growth rates are Croatia (50%) and Romania (35%). Many new EU member countries, however, experience a very dynamic development not only of their exports but also of their imports, reflecting high growth rates of their domestic economies and a rapid reintegration into the world economy. Significantly higher levels of growth in exports than in imports, which indicate a positive trend in net job effects from international service trade, can only be found in three of the ten accession countries: Latvia (57% vs. 35%), Croatia (48% vs. 18%) and Romania (35% vs. 13%). In other words: even in the case of trade between old and new EU member countries service offshoring is likely to be less significant than public debates indicate.

[36] OECD: Information Technology Outlook, 2006, op. cit., p. 113, Figures 3.1 and 3.3.

[37] Ibid., p. 78.

[38] R. Berger: Global footprint design – Mastering the rules of international value creation, Munich 2004, available at: http://www.rolandberger.com/pdf/rb_press/public/RB_Global_Footprint_E_20040819.pdf.

[39] T. Meyer, op. cit.

[40] OECD: Information Technology Outlook, 2006, op. cit., pp. 115-116.